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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1936.

No. [redacted] 16

HENRY O. HALE AND ELIZABETH C. HALE,
*Appellants,*

vs.

THE IOWA STATE BOARD OF ASSESSMENT AND REVIEW, *Appellee.*

APPEAL FROM THE SUPREME COURT OF THE STATE OF IOWA.

## APPELLANTS' BRIEF AND ARGUMENT.

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IN THE

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APPEAL FROM THE SUPREME COURT OF THE STATE OF IOWA.

## APPELLANTS' BRIEF AND ARGUMENT.

### THE OPINION BELOW.

The opinion below is not yet officially reported. It appears on page 7 of this Record and in 271 Northwestern Reporter 168.

### THE JURISDICTION.

Appellants have complied with Rule 12, par. 1; and this court has noted probable jurisdiction of this appeal.

### STATEMENT OF THE CASE.

Various Iowa statutes enacted in and since 1909 provide that bonds issued by the state, or its municipalities, schools and counties either "are not to be taxed", "shall not be taxed", or "shall be exempt from taxation". (R. 6, 7).

In the years after these statutes were enacted, appellants purchased about $750,000 of these tax-exempt bonds, (R. 9, 14).

After such purchases, and in 1934, Iowa enacted a "Personal Net Income Tax" statute, which was construed by the courts below to embrace the interest from appellants' tax-exempt bonds. (R. 20, 21). The question is whether this impairs the contract of exemption, contrary to Article I, sec-10 of the Federal Constitution.

Appellants are individuals. They engage in no trade or profession. They hold no franchise, corporate or otherwise. It was stipulated:

> "4. That all of said interest accrued and was paid to the plaintiffs (appellants) * * * solely because of their ownership of said bonds" (R. 14).

Appellants' tax return stated that they had no business or occupation, but were farm owners and investors (R. 9). The Iowa court accepted this statement, and found that their "business"—if it can be called such "in the broadest sense of the word"—was "that of looking after their farming interests and investing their capital" (R. 20).

Aside from the interest in these bonds, appellants had no taxable income. Their rents and other interest was less than the deductions allowed them (R. 9, 10). The respondent Board ruled that this interest was taxable income, and assessed an income tax based wholly upon it (R. 10).

Appellants properly challenged this assessment: first by application to the Board for its abatement, next by appeal to the *nisi prius* court, and finally by appeal to the state supreme court (R. 8, 11, 15, 16, 19).

## ERRORS TO BE URGED.

All three errors will be urged. They present a single contention: that it was error to hold that the Iowa Income

Tax Law, construed to embrace interest from these tax-free bonds, did not impair the contract of exemption inhering in them, and thus violate Article I, sec. 10 of the federal constitution.

## SUMMARY OF THE ARGUMENT.

The argument may be summarized as follows:

1. The statutory exemption is contractual within the protection of the federal constitution.

2. The scope of the exemption, and whether this tax violates it, are for this court to determine independently.

3. The lower court held that the exemption applies only to property taxes. Even assuming this, an income tax on interest derived from securities is in practical incidence and effect a tax upon the securities; and so a property tax within the exemption contract.

4. But the contractual exemption is not confined to property taxes; it forbids any tax on the bonds, including this tax on their interest, which has always been held a tax on the bonds.

(a) The exemption is broad and general, and cannot by construction be narrowed to exclude only one sort of tax on the bonds.

(b) The exemption cannot be construed thus narrowly in order to save the constitutionality of the later income tax statute.

(c) Previous Iowa cases do not justify construing the exemption to permit the present tax.

5. The exemption is violated whether or not income is said itself to be "property", for this tax still taxes the bonds.

(a) *City of Dubuque v. Northwestern Life Ins. Co.*, 29 Iowa 9 does not involve nor apply to our question, and refused to decide it.

(b) Decisions as to whether a graduated income tax

is forbidden by state constitutions, requiring property taxes to be uniform do not apply here.

6. The exemption cannot be avoided by treating the tax as "in the nature of an excise".

(a) Even an excise on receiving income under a pre-existing contract impairs the obligation of that contract.

(b) There is no excise here, for appellees exercise no taxable privilege which can be the subject of an excise, or of any other tax than one in the nature of a property tax.

(c) The things said below to show appellants "engaged in business" are simple acts of ownership, not taxable as privileges, and a tax because of them is a tax on property-ownership and not an excise.

(d) The statute does not pretend to impose an excise or privilege tax.

7. Calling the tax one on the recipient of income rather than on the income does not avail.

(a) Taxing one because of ownership of property or receipt of such income as this is tantamount to taxing the property or its income.

(b) This tax is explicitly imposed on the income as well as on the recipient.

8. *MacAllen v. Massachusetts* and *Gillespie v. Oklahoma* have not been overruled or made inapplicable by any subsequent decisions of this court. The cases thought to overrule them actually uphold them; and show that whenever the tax is (as here) an income tax rather than a tax upon corporate franchises, it may not include income from exempt securities.

9. *People v. Gilchrist* does not permit this tax or control this case.

10. The power of the state to levy income taxes does not permit it to invade our rights by imposing this tax upon us.

## ARGUMENT.

### The Exemption Was Contractual.

Section 1304 of the Code of 1897, as amended by the parts in italics in 1909 and 1915, provided:

"The following classes of property are not to be taxed:

1. The property of the United States and this state; * * * *municipal, school and drainage bonds or certificates hereafter issued by any municipality, school district, drainage district or county within the State*"—Iowa Code Supplement of 1915, Sec. 1304.

The words "hereafter issued" refer to 1909. (Acts 33 G. A. Ch. 81, p. 75).

In 1921, the Legislature authorized issuance of Soldiers' Bonus Bonds by the State, and provided that:

"* * * all bonds issued hereunder shall be exempt from taxation"—Acts 39th G. A. Ch. 332, Sec. 10.

In 1919, the Legislature authorized the issuance of bonds and certificates for highway construction, and provided:

> "Bonds and road certificates (whether issued in anticipation of special assessments or in anticipation of annual allotments of the primary road fund) shall not be taxed"—Acts 38th G. A. ch. 237, sec. 38.

The latter statute in the same section also provided that:

> "The rate of interest which each bond shall bear shall not exceed five per cent per annum * * * and the county treasurer shall * * * advertise and sell * * * said bonds for the best obtainable price, not less than par plus all accrued interest".

The other bonds had a maximum interest rate and a minimum selling price fixed by similar statutes: Code of Iowa (1935) sec. 4407, 1175, 5298. Appellants purchased their bonds under these statutes, and the lower courts properly treated these exemptions as contractual (R. 22). So

we need not elaborate the settled rule that where a State makes such securities nontaxable, the exemption inheres in the contract made with subsequent bond buyers. Iowa has contracted not to impose a tax. On the strength of that contract, it sold low-yield bonds for par, or more. Obviously, a tax within the purview of the exemption unconstitutionally impairs the contract:

*MacAllen v. Massachusetts*, 279 U. S. 620 at 634;
*Murray v. Charleston*, 96 U. S. 432;
*Merchants Insurance Co. v. Newark*, 54 N. Y. L. 70, 23 Atl. 305;
*Re Assessment of First National Bank*, 58 Okla. 508, 160 Pac. 469;
*Pacific Railway v. Maguire*, 20 Wall. 36;
*Choate v. Trapp*, 224 U. S. 665;
*Farrington v. Tennessee*, 95 U. S. 679;
*Humphrey v. Pugues*, 16 Wall. 326;
Cooley 'Taxation', pp. 355, 356;
26 Ruling Case Law 92.

**This Court must Determine independently The Scope of the Exemption And Its Violation.**

The question is whether a personal income tax on interest derived solely from mere ownership of exempt bonds violates the above contract of exemption. Its solution involves construing the contractual exemption, and determining whether the tax is of such a kind as the exemption forbids. The State Court held that the exemption applied only to property taxes, and that the income tax was in the nature of an excise, and not a tax on property.

In reviewing this decision, this court must determine independently the scope of the contract, and whether the later statute does impair it. The State Court's decision on these cannot be conclusive on this.

"* * * it is the duty (of the Supreme Court of the United States) to determine for itself the existence, construction and validity of the alleged contract, and also

to determine whether, as construed by this court, it has been impaired by any subsequent legislation to which effect has been given by the court below"—*Columbia Railway Gas & Electric Co. v. South Carolina*, 261 U. S. 236 at 245.

"It is a well established doctrine that where the contract clause is invoked this Court must determine for itself the nature and effect of the alleged agreement and whether it has been impaired"—*United States Mortgage Company v. Mathews*, 293 U. S. 232 at 236.

To the same effect are:

*Detroit United Railway v. Michigan*, 242 U. S. 238 at 249;

*Louisana Railway v. Behrman*, 235 U. S. 164 at 170.

Other cases applying this rule to reverse a construction by State Courts of tax exemptions and tax laws, appear hereafter.

**Where Bonds are exempt from taxation, a tax on their income is really a tax on the property in them, and violates the contractual exemption.**

The contract is that these bonds "are not to be taxed"; that they are "exempt from taxation". The lower courts say this means that no property tax can be imposed respecting them. Even this must forbid a levy whose practical effect is to tax them, or whose incidence is on a property right inhering in them. An exemption from property taxes is not too narrow to forbid this income tax. The case cannot depend on the mooted abstract question whether income taxes, *generally* are property taxes, excises, head taxes, or taxes *sui-generis*. It must depend on the practical result of *this* tax upon these appellants and these bonds. If the tax is here essentially one on property-ownership, it is forbidden by an agreement against property-taxation. Whether

the tax infringes on the exemption must depend on its practical incidence and effect:

> *Home Insurance Co. v. New York*, 134 U. S. 594; *Dawson v. Kentucky Distillers Co.*, 255 U. S. 288 at 292.

The tax cannot

> "be placed in a class different than that to which its practical results consign it. Taxation is eminently practical * * * and, for the purpose of deciding upon its validity, a tax should be regarded in its actual practical results rather than those theoretical or abstract ideas the correctness of which is a subject of dispute"—*Knowlton v. Moore*, 178 U. S. 41 at 83.

> "It appears sufficiently from what has been said that we are to look for the practical, rather than the logical or philosophical distinction. * * * Neither the state courts nor the state legislatures, by giving the tax a particular name, or by the use of any form of words, can take away our duty to consider its nature and effect"—Justice Holmes in *Galveston & C. Ry. v. Texas*, 210 U. S. 217.

That cases involving other sorts of incomes, or other aspects of income taxation, sometimes treat a particular income tax as an excise does not mean that this tax can here be so treated. Taxes on incomes *not* derived from mere ownership of property may well be so far removed from property-ownership as not to amount to a tax thereon. But the sole question here is as to the practical nature of a tax on *our* income, received "solely because of the ownership" of contractually exempt bonds. On principle and authority, such an income tax is a tax on the bonds within the purview of a contract not to tax them. It is the substantial equivalent of a tax on them, or respecting them, as property.

This tax was imposed only because appellants received interest inuring to them from the bare fact of their owner-

ship of these bonds. It seems self-evident that when Iowa promised not to tax the bonds, that fairly meant no tax would be imposed because of, or impinging upon, their ownership. The state could not evade that contract by taxing the owners because they own the bonds. Thus, it was conceded in argument below that a poll tax measured by the amount of tax-exempt bonds owned by each citizen would violate the contract not to tax the bonds, because that would be its only practical result or effect. The Iowa credits tax is 6 mills: $6 per bond. The Iowa income tax is roughly 5% of the interest: $2 per bond. If Iowa can tax us $2 per bond merely because our ownership gives us income from it, it can also tax the full equivalent of the $6 credits tax, or even more. In either case, there is nothing on which to base the levy save the fact that we own bonds. But the state promised not to tax that ownership. Even a promised exemption of the bonds as "property" must mean the exemption of the whole property in them, and all its attributes or parts. Taxing income received from the bare ownership of bonds, which accrued solely as an attribute and result of that ownership, has the same practical actual effect as taxing the bonds. Indeed, the income is the *only* practical attribute of property in such bonds. To tax it essentially taxes the bonds. The bondholder cannot use or consume his bonds; all he buys is the income from them; and taxing that income taxes the thing of substance which he has purchased. The income thus received is the essential, distinctive feature of appellants' property in these bonds; the only thing which gives them value or substance. If you can promise a man not to tax bonds he buys from you, and then tax him solely because he receives the income thus purchased, the promise is illusory and unreal. Promises are not thus construed. Similar practices by a private individual would be not only breach of contract, but would have the swift attention of those officials supervising deal-

ing in securities, as fraudulent. In the most obvious, direct and practical sense, a tax on the income received "solely by virtue of ownership" of such bonds is a tax on the property in them.

We shall later show that there is no other taxable subject than the property in these bonds to which this tax can be ascribed: no transaction to tax; no occupation to tax; no franchise or privilege to tax; nothing to tax but an essential attribute of bond-ownership. This demonstrates that the tax is actually a tax on the property in the bonds, for to tax a man solely because of his ownership of property is to tax the property.

The uniform decisions of this court have long made it law that, if for any reason property is immune from taxation, an income tax imposed with respect to income received solely because of its ownership violates the exemption, because that is its practical result. Oklahoma once imposed an income tax on income from exempt oil leases, which this court held void in *Gillespie v. Oklahoma*, 257 U. S. 501, because a tax on income derived wholly from ownership of exempt property was, as regards the exemption, essentially a tax on the property. The court said in part:

> "In case where the principal is absolutely immune from interference, an inquiry is allowed into the sources from which the net income is derived; and if part of it comes from such source, the tax is *pro tanto* void (*Pollock v. Farmers Loan & Trust Co.*, 157 U. S. 429, 158 U. S. 601)—a rule lately illustrated by *Evans v. Gore*, 253 U. S. 245, and applied to a case somewhat like the present by the Supreme Court of Hawaii (*Oahu R. & Land Co. v. Pratt*, 14 Hawaii 126). * * * The same considerations which invalidate the tax on such leases invalidate a tax upon the income from such leases."

*MacAllen v. Massachusetts*, 279 U. S. 620 holds that a state cannot levy an income tax so as to include interest from bonds which it has made tax-free. The Massachusetts

exemption statute was like ours: providing that "the following property and polls shall be exempt from taxation", and then listing certain classes of persons and certain classes of property, the latter including municipal bonds. The state later passed a corporation income tax law. Its courts held that this was not a property tax, but an excise on the privileges of holding a corporate franchise. (The Iowa Personal Net Income Tax cannot be claimed to be an excise of the privilege of holding a corporate franchise, for it applies only to individuals). This court held the Massachusetts tax was not a franchise tax, but merely a net income tax. Having determined that it was only an exaction on the taxpayer in respect of his income, this court held it could not constitutionally include income derived from bonds the state had previously made tax-free. After first finding the tax was "in reality a tax on incomes derived from tax-exempt securities", the court denied the claim that a tax on the interest was not a tax on the bonds, saying:

> "It is impossible to conceal from ourselves that this is varying the form, without varying the substance. It is treating a prohibition which is general, as if it were confined to a particular mode of doing a forbidden thing. * * * If * * * this is the real purpose and effect of the legislation, the tax cannot be upheld without subverting the well established rule that what cannot be accomplished directly because of a constitutional restriction, cannot be done indirectly by legislation which accomplishes the same result. * * * Constitutional provisions, whether by grant or limitation, are to be enforced according to their letter and spirit, and cannot be evaded by any legislation which, though not in terms trespassing on the letter, yet in substance and effect destroy the grant or limitation."

The court concluded that the income tax statute

> "in substance and effect imposes a tax on * * * the county and municipal bonds. * * * The act is void. * * *

> The act impairs the obligation of the statutory contract of the state by which such bonds were made exempt from taxation."

The lower courts obviously recognized they could not uphold the present tax in the face of these decisions; but thought they had been overruled (R 26). The decisions said to overrule them will be later analyzed. We now only say that they have not been overruled, but are only two of many decisions that an income tax cannot include income derived solely from exempt property, for to that extent it is a tax on the property. *Northwestern Mutual Life Ins. Co. v. Wisconsin,* 275 U. S. 136 at 140 holds a State Income Tax on tax-exempt bonds is void as being a tax on the bonds, saying:

> "Certainly, since *Gillespie v. Oklahoma,* 257 U. S. 501 it has been the settled doctrine that where the principal is absolutely immune, no valid tax can be laid on the income derived therefrom. To tax this would amount practically to laying a burden on the exempted principal. Accordingly, the challenged act, whatever called, really imposes a direct charge on the interest derived from * * * bonds, and is *pro tanto* void. * * * This amounts, we think, to an imposition on the bonds themselves, and goes beyond the power of the state."

*National Life Insurance Co. v. United States,* 277 U. S. 508, involving income taxes on interest from tax-free securities, also holds:

> "One may not be subjected to greater burdens on his taxable property solely because he owns some that is tax free. No device or form of words can deprive him of the exemption for which he has lawfully contracted. * * * It is settled doctrine that directly to tax the income from securities amounts to taxation of the securities themselves."

*Pollock v. Farmers Loan & Trust Co.,* 157 U. S. 429, distinguished between taxing incomes derived from trades or

professions, and those derived wholly from ownership of property. It held that while taxing the former kind of income might be deemed an excise or occupation tax on the privilege of engaging in the trade or profession, this could not be said of a tax on incomes of the latter class, and that:

> "(page 558) * * * a tax upon property-holders in respect of their estates, whether real or personal, or of the income yielded by such estates, and the payment of which cannot be avoided, are direct taxes. * * * (page 581). In *Weston v. Charleston*, 27 U. S. 449, it was held that a tax on the income from United States Securities was a tax on the securities themselves, and equally inadmissible."

On rehearing this was reaffirmed. The new opinion in 158 U. S. 601 at 613 and 637 pointed out that the decision meant that a tax on incomes from real estate and municipal bonds was a property tax on the land or bonds. This plainly holds that, whatever may result from taxing other sorts of income, income taxes respecting income derived solely from the ownership of property violate a limitation governing direct taxes on such property, and the violation cannot be escaped by the device of christening the tax an excise. Likewise, *Weston v. Charleston*, 27 U. S. 449 holds that a tax on income from exempt securities is as invalid as a tax on the securities would be. And *Pacific Railway v. Maguire*, 20 Wall. 136 holds that Missouri could not tax the income of a railroad whose property it had agreed on for the exemption, because such tax would violate the contract.

These cases had settled the law in 1909 when Iowa enacted the first of these exemption statutes. The Legislature must have known that its promise of immunity included immunity from tax on both interest and principal. *Knowlton v. Moore*, 178 U. S. 41 (on pages 52, 82, 83) had expounded the *Pollock* Case as holding that a tax on income derived from property was the equivalent of taxing the

property, and had reaffirmed the soundness of that doctrine because such was the practical effect of such a tax. After all, people contract for practical results; and it is rather astounding to the ordinary man to be told that the state which has promised not to tax his bonds, and has thus sold them at a high price for a low rate of interest, may tax that interest (or tax him for receiving it) and by such device avoid the promised result. Whether the contract is broken by an act ought to depend on the actual results of the act, and not on mere abstractions or from the form of words by which the act is authorized.

*Eisner v. Macomber*, 252 U. S. 189 at 205 again says the *Pollock* Case decided that income taxes on rents from land and interest from investments were, in effect, direct taxes on property, because imposed by reason of its ownership; and says such taxes are still so considered. Finally *Willicutts v. Bunn*, 282 U. S. 216 says that, though some species of income taxes may be viewed as excises, under the *Pollock* Case this is not true as to income taxes on interest from bonds, and again holds:

> "A tax on interest is levied upon the return which comes to the owner of the security according to the provisions of the obligation, and without further transactions on his part. The tax falls on the owner by virtue of the mere fact of his ownership, regardless of his use or disposition of the security."

So, if Iowa's contract was not to impose a tax with respect to the property in these bonds, it has violated the contract by taxing us on account of this interest which came to us precisely in the manner above described, and which falls on us merely by virtue of the fact of our ownership. Such a tax is surely a property tax (i. e. a tax on or with respect to property-ownership) within the fair meaning of any rational agreement not to tax the property in these bonds.

It is true that when not dealing with such contracts, or even directly with incomes received from mere property-ownership, the state courts differ as to the abstract nature of an income tax. Some language, used with respect to entirely different situations, is quoted in the opinions below (R. 24, 25). It comes from cases deciding whether a graduated income tax is forbidden by state constitutions providing that property is to be taxed uniformly. Obviously, the question as to what sort of classification keeps the requirement of uniformity, has no bearing on the present case. Where cases turn on whether a tax on our sort of income is a tax on property (even where exemption contracts are not involved), most states have agreed with this court in holding that it is. Thus 26 Ruling Case Law 142, cited below as holding an income tax is "sometimes" an excise (R. 24), actually points out this is not true as to a tax on this sort of income, saying:

> "A distinction may also be drawn between a tax on the income from property and income of a trade, profession or employment. * * * It is now generally conceded that a tax laid directly on the income of property is a tax on the property itself, in accordance with the rules laid down in the federal courts."

Some of the most recent state court decisions making this distinction and holding that an income tax on interest from securities is a property tax on the securities themselves are:

*Hobart Estates v. State Board*, 1 Cal. Ap. (2) 328; 36 Pac. (2) 407 at 409 (holding the state which cannot tax certain property cannot include its income in an income tax).

*Kelly v. Kalodner*, 320 Pa. 180; 181 Atl. 598 at 600, 601 (Holding that a tax on income from money at interest, coupled with an exemption of the principal from other taxation, is in substance and effect a property tax and must be so treated).

*Jensen v. Henneford*, ... Wash. ... 53 Pac. (2) 607;

*Hart v. Tax Commission*, 240 Mass. 37; 132 N. E. 621 at 622;
Opinion of Justices, 220 Mass. 613, 108 N. E. 570 at 574.

Section 1304 of the Iowa Code of 1897, in a separate paragraph exempted as a separate "class of property", the property of the United States. As shown by Section 1304 of the 1915 Code Supplement quoted on Page 5 above, that very paragraph exempting federal property was amended by adding *these* bonds to *that* exemption. The Legislature knew that the exemption of federal property from taxation included the income from that property; for it is settled that the income from federal property is as fully exempt from income taxes as the property is from property taxes. So when the Legislature put these bonds in the same "class of property" which was "not to be taxed", it must have intended the same immunity for these bonds as for the federal property with which they were explicitly coupled. And that immunity was from income taxation as well as other forms of property taxation.

For these reasons, we confidently assert that the original contracts of exemption forbid a personal net income tax embracing interest on these bonds which fall to the owner thereof as part of his ownership. It is self-evident that the present tax is claimed against us wholly by virtue of such interest. That such interest accrued to and was received by us solely by reason of our ownership of the bonds is a stipulated fact (R. 14), and would be obvious if it were not. Upon these considerations, and under these authorities, the tax must amount to a property tax which all agree is forbidden by the statutory contracts of exemption.

## The Contract Cannot Be Construed To Permit This Income Tax Even Though It Is Not A Property Tax.

The statutory contract does not rigidly limit the exemption to "general property taxes". This is not its language. A contractual exemption "must not be read so grudgingly as to thwart the intent of the lawmakers"—*Trotter v. Tennessee*, 290 U. S. 354. This exemption enabled the state to sell its bonds more easily, at higher prices and lower interest. That object could only be attained by a broad immunity; and would be frustrated if the state was understood to reserve the right to impose new forms of taxes. Therefore, broad language is used. The bonds, as a "class of property", are put with federal property, to be equally immune from taxes. That language, given full effect, cannot be limited to "general property taxes", if that means merely millage taxes. It is breached by whatever amounts to a tax on the bonds, however named or evolved. It should not be capable of avoidance by cauistry or indirection. So, if the courts' limitation of it to "general property tax" permits this income tax, it is wrong so to limit the exemption.

It is admitted that a tax on persons levied annually upon and in respect of their tax-exempt bonds would violate the exemption. It would not then be said the tax was on the recipient of the bonds and not on the bonds. The previous argument shows that an income tax on this interest is a tax on the bonds. That showing cannot be avoided by arguing whether the income tax is a general property tax or not. So it cannot be justified by saying, as below, that an income tax is "on the recipient of the income rather than on the income as a thing" (R. 24). Whether nominally laid on the recipient or the income (and the words of our statute put it *on both*), it is a tax on the bonds, even if it is not a "general property tax."

*MacAllen v. Massachusetts*, 279 U. S. 620, rejected the contention that an income tax on interest was not a tax on

the bonds. It said the contractual exemption was impaired by a tax that "is in substance and reality a tax on the income derived from tax-exempt securities", and that any such distinction

> "is varying the form without varying the substance. It is treating a prohibition which is general as if it were confined to a particular mode of doing a forbidden thing."

That statute simply exempted certain sorts of property, including municipal bonds, from taxation. This court held that including their interest in an income tax violated that statutory contract. It must be equally true here that the prohibition is general, and cannot be treated as if it were confined to "general property taxes". It forbids *all* taxes on the bonds.

Our statute does not say merely that the bonds should not be taxed by any levy then in vogue, or except by taxing their income. A Tennessee statute once said that banks should pay a certain tax in lieu of all other taxes. Later Tennessee evolved a new sort of tax, which was applied to banks on the theory the exemption was only from the taxes in vogue at its adoption. This court held the statutory contract could not be so narrowly construed:

> "The state might have been silent as to taxation. It might have reserved the power as to some things and yielded it as to others. It had power to make its own terms. It chose to stipulate for a specified tax, and declared and bound itself that this tax should be 'in lieu of all other taxes'. * * * But the state has, by its revenue law, imposed an additional tax. * * * This is one of the other taxes it stipulated to forego. * * * There is no reservation or discrimination as to any 'other tax'. All alike are included. Such is the natural effect of the language used. The most subtile casuistry to the contrary is unavailing. Under such a contract between individuals, no doubt could have existed. * * * We cannot so hold without interpolating into the statute a clause

> which it does not contain. * * * If it was intended to make an exception to the universality of the exemption, it would have been easy to say so, and it is presumed this would have been done. In absence of any such expression, we can find no evidence of such intent. Our view is sustained by the leading authorities on the subject"—*Farrington v. Tennessee,* 95 U. S. 679.

So here, Iowa contracted not to tax the bonds. This contract cannot be narrowed by permitting it to tax them in actuality, even by something not a general property tax. It must mean that it cannot tax them at all, by any tax, directly or indirectly; for:

> "If this is the real * * * effect of the (tax), it cannot be upheld without subverting the well established rule that what cannot be accomplished directly cannot be done indirectly by legislation which accomplishes the same result"—*MacAllen v. Massachusetts,* 279 U. S. 620.

That, and all other cases in this court, hold that an income tax on interest from exempt property violates the exemption. The abstract classification of an income tax as being a general property tax or something else is wholly immaterial. It does tax the bonds,—though they "are not to be taxed". Beyond that, we are not concerned.

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The lower courts thought they could thus narrowly construe the exemption because the exemption statute "must, if fairly possible be construed to save the constitutionality of *the income tax law*" (R. 22). That is not true. The income tax law must be construed to save its own constitutionality; and so we contended below it ought not to be construed to embrace this kind of interest. Such construction was refused, though it would have prevented any question of the law's constitutionality. It is wholly improper to construe the exemption law so as to sustain a statute passed 25 years

later. An early statute cannot be construed with, or in view of, a later one; even for such a purpose:

*Worthen v. Kavanaugh*, 295 U. S. 56.
*Hoffman v. Quincy*, 71 U. S. 535 at 554.

"The legislative history of an act may * * * be resorted to as an aid to construction. * * * But no aid could possibly be derived from the legislative history of another act passed nearly six years after the one in question"—*Penn Mutual Life Insurance Co. v. Lederer*, 252 U. S. 528.

"The intention of the 50th General Assembly, which passed the act of 1917 cannot be determined by the intention of the 55th General Assembly. * * * Past or concurrent legislation in *pari materia* may be considered in construing a particular statute, but not subsequent legislation. If this were true, the same law might have a different meaning with each passing General Assembly"—*People v. Central Illinois Public Service Co.*, 328 Ill. 440, 159 N. E. 797.

So, the statutory contract cannot be construed to fit a law later passed. Our rights, complete before the income tax law was enacted, cannot be narrowed by fitting them to the very law which impairs them. Their original scope must be preserved without regard to the impairing statute—*Appelby v. New York*, 271 U. S. 364 at 380, and citations therein.

"Legislative contracts are to be read in the light of the policy and purpose at the time they are made, and cannot be changed at a later period when different ideas and theories may prevail"—*Re Assessment of First National Bank*, 58 Okla. 508; 160 Pac. 469; *Mobile & Ohio Ry. v. Tennessee*, 153 U. S. 486.

Never before had Iowa construed this exemption. It had only construed other exemptions contained in section 1304 of the 1897 Code; those exempting municipal property, and property of certain insurance corporations. Those decisions are cited below as authority for saying this exemption is limited to general property taxes (R. 23); but they do not

so hold. None involve income taxation, nor contractual exemptions of any sort.

*Sioux City v. School District*, 55 Iowa 150, 7 N. W. 488, and *Edwards v. Jasper County*, 117 Iowa 365, 90 N. W. 1006, hold the statute exempting municipal property does not apply to a special assessment for street improvements, because such assessment is not a tax at all, but a payment for a special and direct benefit. These are the only cases even using the phrase "general property tax", and they use it only in contradistinction to a special assessment.

*State v. Des Moines*, 221 Iowa 642; 266 N. W. 41, holds that the same exemption does not prevent collection of an excise tax on gasoline laid on the privilege of using the state roads. This case does not even say that the exemption of municipalities applies only to general property taxes, but only that it

> "does not apply to privilege taxes * * *. The * * * tax is not a general tax for general purposes, but an excise in the nature of a privilege tax."

The present tax *is* a general tax for general purposes, being created expressly to displace and reduce the payment of general property taxes. Code of 1935, Sec. *6943-f2* says so:

> "This chapter shall be known as the 'property relief act', and shall have for its purpose the direct replacement of taxes already levied or to be levied on property to the extent of the net revenue obtained from the taxes imposed herein, which shall be apportioned back to the credit of individual taxpayers on the basis of the assessed valuation of taxable property as provided in division VI of this chapter."

No contractual or constitutional questions are involved in these former Iowa cases. The municipality there affected is but an arm of the state, not protected by constitutional immunities of citizens, without right to complain of the

repeal or alteration of any state statute affecting municipal property:

*Scott County v. Johnson*, 209 Iowa 213, at 221, ff; 222 N. W. 378;
*Clinton v. C. R. & C. Ry.*, 24 Iowa 445 at 475;
*Herrick v. Cherokee County*, 199 Iowa 510; 202 N. W. 252.

*Iowa Mutual Insurance Co. v. Gilbertson*, 129 Iowa 658, 106 N. W. 153, only holds that exempting property of an insurance company does not forbid collecting a privilege tax for the use of its corporate franchise. No contractual or constitutional question existed there.

The opinions (R. 21) also cite *Appeal of Van Dyke*, 217 Wis., 528, 259 N. W. 700, as holding the exemption does not forbid an income tax. No constitutional or contractual questions were involved there. Wisconsin had never granted any previous exemption of municipal bond. The legislature which enacted one also included interest in the general income tax. The Wisconsin court, construing the acts of the same session in *pari materia*, and for other reasons here not pertinent, held the Income Tax Law included interest on these bonds. The validity of such construction was not questioned, and could not have been; for there were no bonds issued before the income tax law was passed which could have been impaired by it. This case may be authority for construing the Iowa Income Tax Law to include this interest; but it has no bearing whatever on the question now before this court.

## The Exemption Is Violated Whether Or Not Income Is "Property".

The lower Courts also suggested that income is not property, and a tax on income is not a tax on property (R. 24, 27, 28). If we are right in saying the exemption cannot be confined to property taxes as such, this is not very impor-

tant. But even if the exemption is only from property taxes, income from property is property within the exemptions, whether other sorts of income are or not. This is shown in a preceding division of this argument. The cases cited below do not involve or rule on this question. The only Iowa case mentioned is *City of Dubuque v. Northwestern Life Insurance Co.*, 29 Iowa 9 (R. 27). The court there refused to pass on whether or not the tax involved impaired a contract (See 29 Iowa pp. 1, 12), and said the only question was:

> "Are annual receipts of the insurance company * * * property *upon which the city* may levy and collect taxes? * * * if sustained at all it must be under the authority of the city to collect taxes on 'taxable property'."

The court noted the city had no authority to determine what should be "taxable property" (29 Iowa p. 12). The reason was that the legislature had determined that as follows:

> "All taxable property shall be taxed each year, and personal property shall be listed and assessed each year in the name of the owner thereof *on the first day of January*"—Code of Iowa 1873, sec. 812.

The right of the city to levy this tax did not depend on whether income was property, but on whether it was "taxable property" within the city on January 1, 1868, the date when property had to be owned by the taxpayer, and be in the city to be taxable. This income had not then been received. The case only decided that Dubuque could not claim such income was "taxable property" *on January 1, when its levy must be made.* Also, it did not involve income from property; only income from the insurance business. It does not hold that income from property is not property, much less that the interest from tax-exempt bonds can be taxed without infringing the exemption. If it did,

it is clearly conflicting with the decisions of this court, whch must control.

The other cases cited as holding that income is not property do not deal with income such as ours: i. e. interest from bonds or income from the ownership of property. As the trial judge pointed out, they are all cases determining whether a state constitution requiring property to be taxed uniformly forbids a graduated income tax (R. 24). Such cases fall into two classes: (1) those like *State v. Nichols,* 66 N. D. 355, 265 N. W. 859, holding that if income be property, large incomes can be classified differently from small ones, and uniformity is attained if each class is taxed uniformly; and (2) those from Massachusetts and Illinois holding income is property and such graduated taxes are forbidden by these provisions, and (3) those like *Featherstone v. Norman,* 170 Georgia 370, 153 S. E. 58, which hold that the word "property" is not used in those constitutional provisions in the same sense that it is in exemption statutes, and does not include income because that would defeat its manifest purpose in the light of the constitutional history. The *Featherstone Case* recognizes that *MacAllen v. Massachusetts,* 279 U. S. 620, forbids income taxes on tax-free interest, but says the word "property" is used in a different sense in the state constitution. Manifestly, only the last cases are even remotely important here, and they differ from this because: (a) they do not involve the difference between income derived solely from property and incomes not so derived; (b) they do not involve contracts, or the contract clause of the constitution; (c) they do not involve taxpayers whose money the state has taken, or who have done any act relying on a tax exemption; (d) the purpose and history of the constitutional requirement is so different from the purpose and history of this exemption contract that it affords no fair criterion by which to measure the exemption from taxation.

With these cases we may also group the recent opinion of this Court in *New York v. Graves*, 81 Law Ed. Adv. Op's. 409, filed March 1, 1937.

It merely held that the Fourteenth Amendment did not forbid a state taxing its own citizens on income from lands in other states or bonds secured by such lands. The sole question was said to be whether the due process clause forbad this tax; and the decision merely was that

> "it would be pressing the due process clause * * * too far to say that because a state is prohibited from taxing lands it neither protects nor controls, it is likewise prohibited from taxing the receipt and command of income from this land by its resident, who is subject to its control and enjoys the benefit of its laws."

The due process clause is concerned only with a tax imposed without jurisdiction to tax—without any foundation in returns given the taxpayer by the taxing state or in ability to control the property taxed. The decision merely was that taxing jurisdiction sufficiently appeared.

But the decision recognizes that, under other constitutional provisions, having objects different from the due process clause, such tax is forbidden. The *Pollock case* is said to hold that such tax is so far direct as to be within the purview of constitutional provisions governing direct, rather than excise taxes. "By a parity of reasoning" the immunity of income-producing instrumentalities of one government against taxation by another is extended to its income, because the income tax essentially burdens the property. By like "parity of reasoning", as well as by the authorities on which we rely, this tax is essentially a tax on our bonds within the fair purview of a contract not to tax them, and the contract clause of the constitution protecting such contract.

The basis for the *Graves* decision is that the taxpayer enjoys governmental protection and benefit from the tax-

ing state as to his income which that state does not give him as to his property. There is no such basis for the tax here involved. Iowa agreed not to tax these bonds; and to permit a tax because of their ownership within its borders and the governmental protection thus incidentally afforded them would palpably violate the agreement not to tax them at all.

Under the decisions noted in a prior division of this argument, this income tax is a tax on the bonds; and that suffices to bring it within the limitation which the state, for value received, placed on its power to tax these bonds.

The state can repeal the exemption and tax its bonds thereafter issued. But it cannot repeal the exemption as to our bonds issued under it. It can stop the exemption by paying the bonds; but not by leaving them outstanding and taxing their interest on any refined theory that taxing interest is not taxing the bonds or the property in them.

**The Tax Cannot Be Treated As An Excise To Avoid The Exemption.**

Appellees' sole contention below was the tax escaped the exemption because it was an excise (R. 29, 30).

But there are many kinds of excises. Even an excise may be so laid upon the bonds as to impair the contract:

*Coolidge v. Long*, 282 U. S. 582 at 595;
*Tax Commission v. Rife*, 119 Ohio St. 83; 162 N. E. 390;
*Re Morrison's Estate*, 224 N. Y. S. 346.

The courts below did not "fully adopt the defendants' contention" (R. 22), but did treat the tax as analogous to an excise (R. 24, 26). Still more easily can a tax merely analogous to an excise violate a contract not to tax the bonds.

The language of the Iowa Income Tax Law does not make it an excise. So far as material, that statute is found in

sections 6943-f4 to 10 of the Iowa Code of 1935, which read as follows:

> "Division II. Personal Net Income Tax.
>
> "6943-f4. * * * the word 'resident' applies only to individuals. * * * The word 'individual' means a natural person. * * *
>
> "6943-f5. A tax is hereby imposed, beginning the first day of January, 1934, upon every resident of this state, which tax shall be levied, collected and paid annually upon and with respect to his entire taxable income, as herein defined, at rates as follows (table of rates not material). * * *
>
> "6943-f7. The term 'net income' means the gross income of the taxpayer less deductions allowed by this division.
>
> "6943-f8. 1. The term 'gross income' includes gains, profits and incomes derived from salaries, wages, or compensation from personal service, of whatever kind and in whatever form paid, or from vocations, professions, trades, business, commerce, or recurring profits and income growing out of the ownership or use of or interest in property, real or personal; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit; or gains or profits and income derived from any source whatever, and in whatever form paid. * * *
>
> "2. The term 'gross income' does not include the following items, which shall be exempted from taxation under this division." (listing various items, principally capital gains; insurance; property acquired by gift or inheritance, but not income on such property; interest on federal obligations; salaries of federal officers; stock dividends).

Sections 6943-f9, 10 list allowable and unallowable deductions from gross income, the details not being material.

Since this tax applies only to individuals, it must not be confused with an excise on corporate franchises measured by income. Corporations are taxed separately under Division III of this statute (Sec. 6943-f29, *et seq.*). This is important because the lower courts cited federal cases which

are not in point because they are explicitly restricted to corporate franchise taxes.

This statute does not in terms pretend to lay an occupation tax, or a tax on the privilege of receiving income, or any other sort of excise. In this respect it is like the one annulled in *Galveston Ry. v. Texas*, 210 U. S. 217, which said:

> "This is merely an effort to reach * * * receipts, not even disguised by the name of an occupation tax."

If this is an excise as to us, it is not from its terms, but because of its effect. But it has no such effect. As to us, it lacks the distinctive features of an excise. So it cannot escape our exemption on the ground that it is in the nature of an excise.

> "Excises are 'taxes laid upon the manufacture, sale or consumption of commodities within the country, upon licenses to pursue certain occupations, and upon corporate privileges', which appears to cover the whole ground"—*Flint v. Stone Tracy Co.*, 228 U. S. 107 at 151.
>
> "We think the words ('duties, imposts and excises') were used comprehensively to cover customs and excise duties imposed on importation, consumption, manufacture and sale of certain commodities, on privileges, particular business transactions, and the like"—*Thomas v. United States*, 192 U. S. 363 at 370.

None of these things exist here, and it cannot be fairly said that this income tax is laid on any of them. There is no taxable subject separate from our ownership of these bonds. So the tax must be on the bonds, and thus a violation of the contract not to tax them. If it is not on ownership of the bonds, on what is it laid?

The authorities cited in this connection by the opinions below all involve excises on some taxable privilege; mostly the privilege of a corporate franchise. But what privilege do these appellants exercise which can be the subject of a

tax? Before the tax can be a privilege tax, there must be a privilege for it to tax.

> "A privilege tax * * * is imposed on the right to exercise a privilege, and its payment is invariably made a condition to the exercise of that privilege"—*Ingels v. Riley*, 5 Cal. (2d) 154; 53 Pac. (2) 939 at 942.

This statute grants no privilege, mentions none, and exacts payment for none. We exercise none. Appellants have no profession or trade on which to levy an occupation or license tax. They merely hold land and bonds, and receive interest from these bonds "solely because of their ownership". The Iowa Supreme Court suggest that appellants engaged in business "in the broadest sense of that term" because they owned these farms and securities, and thus occupied "the status of investors of capital"; that in view of "the energy expended in an endeavor to make the farm pay or realize returns on such investments, they might well be said to be engaged in the business of farming" (R. 19, 20). It cannot be seriously contended that this discloses anything separate from property-ownership on which any occupation, license or privilege tax can be laid. In fact, the court later said that this "required labor, thought and energy, *all of which is included in ownership*, in husbanding this large fortune" (R. 29). Thus it recognizes, perhaps unconsciously, that appellants do nothing more than own and hold property.

If our mere "status as investors of capital" is the foundation of a tax, it is on the invested property, and in the nature of a property tax rather than an excise. If we were engaged "in the business of farming", that would not warrant taxing the interest from our exempt bonds. The statute does not impose an occupation tax on farmers measured by their income from exempt bonds. Energy may be spent in husbanding the property, without any act or conduct taxable as a privilege. The opinion points to no taxable privilege;

its language indicates nothing but ordinary property-ownership, and if the tax is based on any such subject it is self-evidently a property tax.

Property-ownership is not the subject of an excise. If that be what is taxed, the tax must here be treated as on the bonds, and not an excise.

> "The individual, unlike the corporation, cannot be taxed for the mere privilege of existing. The corporation is an artificial entity, and owes its existence to the charter powers of the state, but the individual's right to live, *and to own property* are natural rights, for the enjoyment of which no excise can be imposed"—*Redfield v. Fletcher,* 135 Ore. 180, 292 Pac. 813.

> "The mere right to own and hold property such as is referred to * * * cannot be made the subject of an excise"—*Opinion of Justices,* 195 Mass. 607, 84 N. E. 499.

> "The mere right to own and hold property cannot be made the *subject of an excise,* because, to tax by reason ownership of property is to tax the property itself"—*Jensen v. Henneford,* 185 Wash. 209, 53 Pac. (2) 607 at 610.

Nothing which the Iowa court describes us as doing can be properly separated from the mere ownership of property. All owners do what they can, with the energy or ability at their command, to "husband" it. That is an attribute and concomitant of ownership; not a separate taxable subject. Basing a tax thereon is basing it essentially on ownership, and not on the exercise of any taxable privilege.

*Dawson v. Kentucky Distillers Co.,* 255 U. S. 288, condemned a tax no further from one on ownership as being one on property and not an excise:

> "The name by which a tax is described is, of course, immaterial. Its character must be determined by its incidents; and obviously it has none of the incidents of an ordinary occupation tax. * * * It is not on the occupation of the warehouseman. The tax might be said

> to be upon the act of removal (of whisky) from the bonded warehouse. But * * * the thing really taxed is the act of the owner in taking his property out of storage. To levy a tax by reason of the ownership of property is to tax the property. * * * It cannot be made an occupation or license tax by calling it so."

If taxing the owner's removal of his goods from storage is a tax on a mere act of ownership, surely a tax justified because the owner looks after his own farms and conserves his own bonds, is also one on the mere act of ownership, and not an excise.

The obvious truth is that appellants do nothing which is a privilege at all. The things they do are matters of common right, inhering in any property-ownership; not a privilege, but an absolute right.

The only other thing which could conceivably be the subject of an excise, either as a privilege or transaction, is our receiving the interest for which these bonds provide. In a sense, such receipt is a transaction. But it is not a taxable transaction; and it certainly is not a privilege but a right. Appellants receive the income merely from the property, under the contract the state has agreed not to tax and as part of that contract, without any further transaction on their part. If the receipt of money is ever a privilege or transaction which the state may tax as such, that is not true of a payment which comes in as a matter of absolute right, under a pre-existing contract. Such a tax is essentially and actually a tax on the bonds. This is pointed out in *Willicuts v. Bunn*, 282 U. S. 216:

> "A tax on interest is levied upon the return which comes to the owner of the security, according to the provisions of the obligation and without further transaction on his part. The tax falls on the owner by virture of the mere fact of his ownership."

Such a tax cannot be an excise, for there is no privilege to tax. Receipt of property by devise or inheritance is us-

ually a taxable privilege. The lower courts thought this tax could be likened thereto (R. 26, 27). But where one has a fixed contractual right to receive money, even an inheritance tax cannot be imposed thereon, for, though an excise, if applied in such a case, it impairs the obligation of the contract. *Coolidge v. Long*, 282 U. S. 582 held that where a contract existed whereby property was to pass on the death of a person, a later inheritance tax on such transmittal—admittedly an excise—impaired the obligation of such contract:

> "The trust deeds are contracts within the meaning of the contract clause of the constitution. They were fully executed before the taking effect of the state law under which the excise is claimed. The Commonwealth was without authority by subsequent legislation, whether enacted under its power to tax or otherwise, to alter their effect or impair or destroy rights which had vested under them."

Before this Income Tax Law, appellants had the contractual right to receive this interest. The contract was fully executed. That receipt was not a privilege; and could not be taxed as such. No excise can be levied on the "privilege" of receiving payment to which the recipient is theretofore contractually entitled by a pre-existing tax-free contract. So in *Re Morrison's Estate*, 224 N. Y. Suppl. 346, a statute had exempted from taxation funds accumulated in a Teachers' Retirement Fund, which plaintiffs were entitled to receive on the teacher's death. The state later sought to impose an inheritance tax as an excise for the privilege of this transmittal. The court held there could be no excise on this transaction, because the payment came to plaintiff not as a privilege, but by absolute right, accorded by the statute governing the fund. And in *Tax Commission v. Rife*, 119 Ohio St. 83, 162 N. E. 390, Ohio attempted to collect an inheritance tax on the transmittal of war risk insurance;

but it was held impossible, because the transmittal was not a privilege but a right, the court saying:

> "The right to take this property is by virtue of a contract between the United States and the soldier, and does not arise by reason of the statutes of descent of this state."

In *Jensen v. Henneford*, 185 Wash. 209, 53 Pac. (2) 607, at 610, the state income tax law was explicitly phrased to be a tax "upon the privilege of receiving income". It was held no excise could be laid, as to income received wholly from property, for that was not a privilege at all, but an absolute right. The court said in part:

> "The character of the tax is determined by its incidents, not by its name. * * * When a tax is in truth levied for the exercise of a substantive privilege granted or permitted by the state, the tax may be considered an excise tax and sustained as such. * * * But the mere right to hold and own property cannot be made the subject of an excise, because to tax by reason of ownership is to tax the property itself."

In *Thompson v. McLeod*, 112 Miss. 383, 73 So. 193, a tax on turpentine taken by a man from his own trees was held not an excise, but a property tax, because that taking was an absolute right and not a privilege, so that

> "It requires no refinement to observe at once that this is an additional burden of taxation, operating not indirectly, but upon complainant's own property."

This court holds in *Helson v. Kentucky*, 279 U. S. 245, that a state cannot impose an excise tax on what is a matter of absolute right and not a privilege—their doing interstate business.

In *Corn v. Fort*, ... Tenn. ...; 95 S. W. (2) 620, the income tax was claimed to be on the privilege of doing business in partnership. It was held that this was not a taxable privilege but a right, and such excise could not be sustained.

We therefore submit that the Iowa tax cannot be treated

here as an excise so as to avoid our exemption. There is nothing which can be the subject of an excise. The statute itself recognizes that income "from interest, rent, dividends or securities" differs from income from "the transaction of any business carried on for gain or profit" (Sec. 6943-f8 quoted on page 27 above). It does not pretend to impose a privilege tax, a transaction tax, an occupation tax, or any kind of excise. It imposes the tax directly and literally "upon and with respect to the taxable income" (Sec. 6943-f5 quoted above). Appellants exercise no privilege or act separable from their property-ownership, to which this tax can be ascribed as an excise. If it were an excise on the receipt of the income, it would still unconstitutionally impair these contracts, under the rule of *Coolidge v. Long*, 282 U. S. 582, quoted above, so it will not help the state to argue that the tax can be ascribed thereto.

The lower courts say *Brushaber v. Union Pacific Railroad*, 240 U. S. 1, says an income tax is an excise. That statement is made relative to income *not flowing from property alone*. The opinion on page 16 reaffirms the *Pollock Case* in holding that taxing our income is not an excise,

> "since to burden the income by a tax was to burden the property from which the income was derived, and thus to accomplish the very thing which the provision was designed to prevent."

Our exemption statute, if enacted in good faith, surely agreed that the bonds would not be burdened by taxation; and under this language a tax on their income does burden them, and invades their immunity.

It thus appears that this tax has not the essential features or result of an excise which can be imposed without so burdening tax exempt property as to violate the exemption. Regardless of whether it is in the nature of an excise in some other sense, or as to some other incomes, it cannot be imposed here.

## The Exemption Is Not Avoided By Calling The Tax One On The Recipient Of The Income Rather Than On The Income As Such.

The opinions below also suggest that an income tax is justified as a tax on the recipient of the income rather than on the income as a thing (R. 24).

What has heretofore been said disposes of this makeweight. To tax a person by reason of his ownership of property is to tax the property. To tax the income received solely from ownership of property is also to tax the property. Therefore, to tax a person because he is the recipient of income inuring to him "solely because of the ownership" of bonds is, by the same token, to tax the bonds.

Furthermore the Income Tax Statute above quoted, imposes the tax "on and with respect to taxable income" and thus *is* on the income as well as on the recipient.

The cases speaking of income tax as a tax on the recipient of income neither consider nor involve the distinction between our sort of income and incomes generally. They do not involve or consider questions of contractual exemption, or the rights growing therefrom. They do not bear, even remotely, on the contract clause of the constitution, nor rule our case which depends wholly upon the guarantees of that clause.

## The Doctrine of MacAllen v. Massachusetts And Gillespie v. Oklahoma Has Not Been Overruled Or Made Inapplicable.

The foregoing discussion makes it easy to show the fallacy of the view (R. 26) that this court has overruled *MacAllen v. Massachusetts* or made it inapplicable. The cases said to have that effect are *Pacific Co. v. Johnson*, 285 U. S. 480, and *Educational Films Co. v. Ward*, 282 U. S. 379.

The lower courts refer to the dissents in *MacAllen v. Massachusetts*. In that case, however, all the judges there

agreed that if the state laid a net income tax to include interest from tax-free bonds, it was *pro tanto* void. The minority disagreed because they thought the Massachusetts statute did *not* impose an *income tax* at all, but only a tax on the privilege of exercising a corporate franchise. The Massachusetts statute applied only to corporations, and so might be thought to impose a franchise tax and not an income tax. The unanimous holding in *MacAllen v. Massachusetts* is that, once we find the tax *is a net income tax*, and not a corporate franchise tax, it cannot include interest from contractually exempt bonds. Admittedly, the Iowa Tax is an income tax and not a franchise tax. It is labeled an income tax. It is levied specifically on and with respect to incomes. It explicitly excludes corporations; and so cannot be a tax on their franchise.

*Pacific Co. v. Johnson*, 285 U. S. 480, and *Educational Films Co. v. Johnson*, 282 U. S. 379, involve franchise taxes on corporations. They also agreed that *if* the taxes there involved were *income taxes*, and not franchise taxes, they could not include income from tax free bonds. They do not overrule the *MacAllen* Case on any point; and on the point now before the court they approve it. So *Pacific Co. v. Johnson*, 285 U. S. 480,

> "* * * the question still remains whether the immunity is broad enough to secure freedom from taxation of a corporate franchise tax to the extent it is measured by tax exempt income.
>
> "The rule that a tax upon a franchise * * * is not an infringement of that immunity was re-examined and affirmed in *Flint v. Stone Tracy Co.*, 220 U. S. 107, which was accepted as authority in *MacAllen v. Massachusetts*, 279 U. S. 620, and followed in *Corp v. Ward*, 282 U. S. 379.
>
> "This distinction, often and consistently affirmed, is but recognition that the franchise, the privilege of doing business in the corporate form, is a legitimate subject of taxation and does not cease to be such subject because it is exercised in the acquisition and enjoyment

> of nontaxables. The distinction is one of substance and not of form, and has been so recently discussed in *Ed. Films Co. v. Ward* that it need not be elaborated here. It suffices to say that the tax immunity extended to property, qua property, does not embrace a special privilege, the corporation franchise, otherwise taxable. * * * The owner may enjoy his exempt property free of tax, but if he asks and receives the benefit of a taxable privilege as the implement of that enjoyment, he must bear the burden the state exacts as its price."

This means that the tax to be sustained must be a franchise privilege tax, and not a mere income tax. It recognized the owner may enjoy his exempt property (and that means its income) free of the tax, unless he asks and receives from the state some additional privilege for which it can exact a tax. It necessarily implied that an income tax cannot be imposed on and with respect to this interest; for otherwise there would have been no need to point out so carefully that the tax there was not an income tax but a franchise tax. The majority in the *Johnson Case* did not challenge the statement in the dissent that:

> "It is not denied, as we understand, that if the state had laid the tax directly on the income derived from the bonds, an unconstitutional impairment of the obligation would have resulted."

The question was whether that tax, distinctly laid on a separate taxable privilege, might value the privilege according to income. The majority, holding it might, recognizes a distinction "*of substance*" between so doing and taxing income. We have no question of valuing a privilege by exempt income, for our tax is laid on no privilege, and there is no privilege to value. We have owners of exempt property seeking simply to enjoy that property free of taxation on the interest accuring to them solely from their ownership; and the Johnson case recognized that must be conceded.

*Educational Films Co. v. Ward*, 282 U. S. 379, was exactly like the *Johnson* Case. It recognizes explicitly the rule for which we contend, saying that if the tax

> "is in reality a tax on income it as such falls within the class of taxes which concededly may not be imposed"

and points out that the franchise tax is levied wholly for the privilege of doing business; is not a tax on the income of the corporation in a given year, but on the privilege of doing business this year measured by last year's income; that it cannot exist independent of the enjoyment of the corporate franchise, and can be levied only when the corporation both seeks and exercises that privilege. It says that there is a distinction between a tax "invalid because laid directly upon * * * income derived from" securities, and a franchise tax. It does not say the *MacAllen* case is overruled, but holds that the statute involved in the *MacAllen* case was not a franchise tax but an ordinary income tax and thus is

> "brought within the purview of *Miller v. Milwaukee*, 272 U. S. 713, with respect to a state tax on income, no franchise or privilege tax being involved."

These cases, far from overruling *MacAllen v. Massachusetts*, reaffirm it.

The article in 30 Columbia Law Review, 92 at 100, is cited below as criticizing the *MacAllen* case (R. 26). But it finds no fault with the rule that a tax on income from exempt bonds violates the exemption; but only questions the holding that the Massachusetts tax *was* an income tax rather than a franchise tax. With that we are not concerned.

The idea (R. 26) that *Burnet v. Coronado Oil Co.*, 285 U. S. 393, made *Gillespie v. Oklahoma*, 257 U. S. 501, inapplicable here is refuted by the following quotation from *Burnet v. Coronado* itself:

> "We are disposed to apply the doctrine of *Gillespie v. Oklahoma* strictly, and only in circumstances closely analogous to those it disclosed. In principle, however, the present claim of exemption cannot be distinguished from the one presented in the earlier case, and we adhere to the rule there approved. * * * The opinion in *Gillespie v. Oklahoma* has often been referred to as the statement of an accepted principle."

That accepted principle is that an income tax on the income from tax-exempt property violates the exemption of that property from taxation. That principle rules this case; and the citations and suggestions of the lower courts show nothing that properly escapes it.

**People v. Gilchrist, 262 U. S. 94, Does Not Permit This Tax.**

The only authority cited by the lower courts which is not fully met by the previous discussion is *People v. Gilchrist*, 262 U. S. 94, (R. 23). That decision is that, since the state courts rendered no opinions, this court could not be sure what their ruling was and was unable to perceive error. The judgment was merely affirmed, not as sound, but as having some plausible foundation. Such affirmance is of little value as a precedent. The situation seems to have been this: a statute provided that on payment to the local recorder of a fee for recording a mortgage, or paying a millage tax to the state comptroller instead of the local collector, the mortgage debt should be exempt from further taxation. A later income tax law included interest on mortgages. This court said in substance: (a) that the state statute might have meant the mortgage should be only exempt from taxation by the local authorities, but not by the state; or (b) that the exemption might have been only for the year during which the recording fee or millage tax was paid, since the payment of those taxes as an alternative for others would be consideration only for the period they paid for; or (c) that, since the state got no benefit from the exemp-

tion, it was not presumed to have abrogated its power to levy new forms or tax by merely imposing a recording fee, for the state did not need to offer any such bargain to induce people to record mortgages. None of these considerations apply here. Iowa did get a benefit from this bargain, which enabled it to sell its bonds at a high price for a low yield. The term our exemption paid for has not expired; it runs so long as the bonds issued under it remain outstanding. It is broader than an exemption for merely one year.

*People v. Gilchrist*, therefore involves a situation different from ours in the nature, scope and purpose of the exemption; and the foregoing considerations, which induced it, do not rule us. Why take the earlier case of *People v. Gilchrist*, confused by many considerations not here applicable, to the exclusion of the later cases of *MacAllen v. Massachusetts; Northwestern Mutual Life Insurance Co. v. Wisconsin*, 275 U. S. 136, and *National Life Ins. Co. v. United States*, 277 UP. S. 508, all of which hold explicitly that an income tax on interest from exempt securities is a tax on them to violate the exemption? *People v. Gilchrist* was not supposed to impair or overrule *Gillespie v. Oklahoma*, 257 U. S. 501, which lays down as an accepted principle, later recognized, that income from exempt property is as immune from income taxation as the property is from property taxation. We submit that those cases, and not the Gilchrist case, apply here.

## CONCLUSION.

The validity of this tax, and the decision whether it impairs our constitutional rights, does not depend on Iowa's abstract power to tax incomes, nor on the validity of its income tax law as a whole, or as applied to others. Its validity depends on its effect on appellants (*White v. John-*

*son*, 282 U. S. 267 at 373). A tax which a state may, abstractly or generally, have power to levy is

> "void in particular cases, either as unconstitutional * * * violation of contracts * * * or because in some other way they operate to deprive the complaining party of a right secured him by the Constitution of the United States."—*General Oil Co. v. Clark*, 209 U. S. 211 at 228.

No matter how constitutional the law may be as applied to persons generally, it cannot apply to us to include this interest and to that extent is *pro tanto* void.

Respectfully Submitted,

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